Proposed Best Practice Recommendations on Information Handling with Illustrative Examples

INTRODUCTION

The TMPG has proposed a set of recommended best practices related to the sharing and use of confidential information in the Treasury, agency debt and agency MBS markets with the aim of promoting integrity and efficient market functioning in these TMPG-covered markets. These draft guidelines are intended to be incorporated into the *Best Practices for Treasury, Agency Debt, and Agency Mortgage-Backed Securities Markets* (*Best Practices*), which are intended for all market participants in the TMPG-covered markets.

Among other proposed practices, the TMPG recommends that market participants identify and develop policies and procedures to address the handling of confidential information, and ensure that confidential information obtained or created is not shared or used with the intent to adversely affect the interests of other market participants or the integrity of the market. The TMPG also recommends that market participants should make available to their counterparts their own practices on handling confidential information, and should have the ability to engage with trading counterparts about how their own confidential information is handled. The TMPG also believes that it is essential that market participants communicate in a clear and truthful manner.

In recent years, there have been a number of serious cases of inappropriate and illegal conduct involving certain communication practices and the misuse of confidential information.[1] The misuse of confidential information adversely affects the integrity of the market by undermining trust and confidence and, moreover, may constitute illegal activity. Nevertheless, there are legitimate reasons for appropriately sharing and using confidential information in certain circumstances.

The proposed best practice recommendations developed by the TMPG were informed by policy initiatives such as the Financial Stability Board's *Foreign Exchange Benchmarks*, the Bank of England's *Fair and Effective Markets Review*, and the *FX Global Code* developed by a partnership of central banks and market participants.[2]

The TMPG invites feedback on this material by October 15, 2017 at tmpg@ny.frb.org.

[1] *See, e.g.*, the May 20, 2015 guilty pleas by five major financial institutions to conspiring to manipulate the price of U.S. Dollars and Euros in the foreign currency exchange (FX) spot market; the several guilty pleas and deferred- or non-prosecution agreements related to major financial institutions' attempts to manipulate the London Interbank Offered Rate (LIBOR).

[2] See, Foreign Exchange Benchmarks, Fair and Effective Markets Review, and FX Global Code.

RECOMMENDED DRAFT BEST PRACTICES

The TMPG is proposing that the following best practice recommendations associated with communication and sharing and use of confidential information be added to the existing *Best Practices*. For purposes of the TMPG's current work, confidential information is described as follows:

Confidential information may include non-public information – received or created by a market participant or its counterparties – relating to the past, present, and future trading activity or positions of a market participant or its counterparties. The nature and types of confidential information may vary across firms and may include, for example, the identity of market participants, their positions or trading strategies, details of their order book including the size and type of trades (limit, market, etc.) or axes.

1. **Market participants should communicate in a manner that is clear and truthful.** Market participants also should not omit any material fact or qualification if the omission would cause the communications to be misleading.
2. **Market participants should not share or use confidential information with the intent of adversely affecting the interests of other market participants or the integrity of the market.**
3. **Market participants should limit sharing and use of confidential information**. Market participants should exercise care in disclosing confidential information, including own position information and information received from counterparties or third parties, whether internally or externally.
   - **Internal sharing:** Confidential information about unexecuted, pending, or executed trades should not be shared internally except on a need to know basis.
   - **External sharing:** Market participants should not disclose confidential information to other market participants that could reasonably enable those market participants to anticipate the flows of a specific counterparty, including flows or information related to transactions to be executed at a to-be-determined time or level. Confidential information about specific pending or executed trades may be shared externally only to the extent necessary to facilitate the execution, clearing or settlement of a transaction (which may include arranging offsetting transactions). The amount of confidential information shared to facilitate a transaction should be minimized.
   - **Market color:** Market color should be shared in a manner that does not disclose any confidential information. For example, market color should not directly or indirectly reveal confidential information about specific (i) market participants' identity, (ii) times of execution, (iii) pending trading activity or orders (including entry and exit points) and (iv) position size.
   - **Own information:** Market participants should exercise particular care when sharing confidential information about their own trading positions, especially when it is a large position relative to the floating supply. Own trading position information may be shared externally only to the extent necessary to facilitate a transaction. For example, such information sharing should not be undertaken with the intent to influence market prices or negatively impact market functioning. Confidential information about trading positions may

include, but is not limited to, individual trades, open orders, positions or investments, axes or inventory.

4. **Market participants should adopt written policies and procedures that identify and address the handling of confidential information, including limitations on the sharing and use of such information.** The policies may vary and should address risks, where they exist, associated with:
   - **Sharing of information:** The extent to which confidential information, including pre- and post-trade information, can be shared internally or externally. The policies should also address the extent to which confidential information should be aggregated or anonymized prior to sharing.
   - **Use of information:** The extent to which confidential information may be used, including, for example, in activities such as customer facilitation, investment decisions, trading or hedging.
5. **All market participants should be aware of their counterparties' practices for handling confidential information; market participants should make available their practices for handling confidential information to their counterparties.** Such practices may be high-level summaries of internal policies and may include, but are not limited to, the handling of confidential information related to requests for quotes, requests for indicative prices, axes or other indications of trading interest, cover information, the placement of orders, inventory and details of completed transactions.
6. **Market participants should establish internal controls designed to ensure that confidential information is handled in a manner that complies with the established policies.** Such internal controls may include training of employees who have access to confidential information.

ILLUSTRATIVE EXAMPLES

The TMPG also developed a draft set of examples to illustrate situations when certain information handling best practices could apply. The examples are highly stylized and are not intended as, nor should be understood as, precise rules, prescriptive or comprehensive guidance. The examples are not intended to provide safe harbor, nor are they an exhaustive list of situations that can arise. In some examples, specific market participant roles are used to make the example more realistic, but the illustrated behavior should apply to all participants in the TMPG-covered markets. The examples are grouped with specific recommended best practices, although some examples may relate to more than one best practice. The examples provided are instructive, and market participants should exercise their own judgment in handling confidential information in a professional and responsible manner and be consistent with their information handling policies.

Draft best practice text	Examples
1. **Market participants should communicate in a manner that is clear and truthful.** Market participants should not omit any material fact or qualification if the omission would cause the	**1A.** A money manager is selling a security through a bid-wanted-in-competition (BWIC) with a reserve and a dealer has the most competitive price, and this bid has met the money manager's reserve level. The money manager should not imply that the dealer may

communications to be misleading.	need to raise its price for its price to be transacted. This communication is misleading since the dealer has already provided the most competitive price.
	1B. A hedge fund has a large voice order which it decides to break into several small orders. It would be misleading, when soliciting pricing for one of the small orders, if the hedge fund implied to prospective counterparties that one of the small orders was the full order.
	1C. A dealer intends to be a buyer of a certain security, but tells its counterparties that it is a seller of that security. That communication would be misleading as it does not reflect the dealer's actual intention.
	1D. A money manager has established a practice of disclosing covers to all of the dealers that provide bids for off-the-run TIPS. On a recent sale, the cover was 10/32nds of a point. The money manager tells the dealer that purchased the TIPS security that the cover was "a few ticks". This communication would be inappropriate as it is misleading and untruthful.
2. Market participants should not share or use confidential information with the intent of adversely affecting the interests of other market participants or the integrity of the market.	**2A.** If a dealer receives an inquiry from a potential counterparty for a large block of securities, it should not advertise that there is a large block of securities that the counterparty is trying to trade without authorization from the counterparty. If the dealer shares this information with market participants that it expects may be interested and able to complete a related trade, the information shared should be limited to what is necessary to complete the transaction.
	2B. If a money manager were to provide several dealers with a list of MBS specified pools that the money manager wanted to sell through a BWIC, these dealers should not reveal the identity of the money manager that is conducting the BWIC, either explicitly or implicitly, for example through the use of code words in the absence of authorization from the money manager.
	2C. A dealer participates in a request-for-quote (RFQ) where there is no execution, or where the dealer did not transact. The dealer is likely still in possession of

	confidential information and should treat it as such.
3. Market participants should limit sharing and use of confidential information. Market participants should exercise care in disclosing confidential information, including own position information and information received from counterparties or third parties, either internally or externally. ▪ **Internal sharing:** Confidential information about pending or executed trades should not be shared internally except on a need to know basis. ▪ **External sharing:** Market participants should not disclose confidential information to other market participants that could reasonably enable those market participants to anticipate the flows of a specific counterparty, including flows or information related to transactions to be executed at a to-be-determined time or level. Confidential information about specific pending or executed trades may be shared externally only to the extent necessary to facilitate the execution, clearing or settlement of a transaction (which may include arranging offsetting transactions). The amount of confidential information shared to facilitate a transaction should be minimized. ▪ **Market color:** Market color should be shared in a manner that does not disclose any confidential information. For example, market color should not directly or indirectly reveal confidential information about specific (i) market participants'	**3A.** If a money manager is looking to sell a large MBS pool, a dealer MBS trader receiving that information through internal salesperson A should not tell internal salesperson B who does not have a need to know the name of the potential counterparty. **3B.** A dealer's repo desk shares confidential information with its Treasury trading desk about which securities a client is short. In the absence of a client's authorization, this would be inappropriate internal sharing of confidential information if the Treasury trading desk does not need to know the position and/or be involved in the repo transaction. **3C.** A salesperson and a trader at a dealer should not communicate confidential information using a system that can be viewed or heard by a wide variety of employees that do not have a need to know such information. For example, using a "hoot" to communicate confidential information is likely to result in such information being shared with those that do not need to know. **3D.** A market participant's dealer desk provides its affiliated asset management trader with confidential information about what strategies another asset manager is executing. This would be inconsistent with the best practices as the asset management affiliate is not involved in the facilitation of trades for the market participant's clients. A market participant should treat an affiliated asset manager as it would treat any other external market participant when considering the appropriate handling of confidential information. **3E.** A dealer's back office is having problems recognizing or settling a transaction with a particular customer and reaches out with confidential information to a wide range of individuals on the trading desk. This would be inappropriate because a dealer back office should not broadly share this confidential customer clearing information with trading desk personnel who do not have a need to know this information because they are not assisting in the clearing or settlement of the trade.

identity, (ii) times of execution, (iii) pending trading activity or orders (including entry and exit points) and (iv) position size. ▪ **Own information:** Market participants should exercise particular care when sharing confidential information about their own trading positions, especially when it is a large position relative to the floating supply. Own trading position information may be shared externally only to the extent necessary to facilitate a transaction. For example, such information sharing should not be undertaken with the intent to influence market prices or negatively impact market functioning. Confidential information about trading positions may include, but is not limited to, individual trades, open orders, positions or investments, axes or inventory.	**3F.** At a dealer's widely attended internal general market update meetings, the sales team, traders, strategists and managers discuss recent market activity. At these general market update meetings, information explicitly describing the confidential trading activity of a specific client should not be discussed, as there is no need for this broad group to know such confidential information.
	3G. A dealer has both a market making desk and a separate investing arm or proprietary trading desk. The Treasury trader on the separate arm or desk should not be privy to the confidential customer information flow on the Treasury market making desk, since the Treasury trader on the separate arm or desk does not have a need to know. A dealer's market making desk should treat the traders on its separate investing arm or proprietary trading desk as it would treat traders at an external market participant when considering the appropriate handling of confidential information.
	3H. A hedge fund sends a group request to a number of dealers and asks them to provide a valuation for certain specified positions to be used for marking its books at the end of a period. The valuations are confidential information and the hedge fund should not disclose one dealer's valuation to another and the dealers responding should not share their valuations with each other.
	3I. A money manager provides a dealer with another dealer's axes or inventory. This is inconsistent with the best practice because the dealer's axes or inventory are confidential information not intended to be shared with competitors.
	3J. A trader at Firm A used to work with a trader at Firm B, and the two have remained friends even though they now work at different firms. The traders should exercise extra care when discussing markets, and because they are not facilitating a transaction, they should not discuss confidential information such as their own trading positions. In addition, as agreements to unreasonably restrain competition are

	illegal, traders from competing firms should be especially mindful that the sharing of confidential information can create an inference that such an unlawful agreement has been reached.
	3K. It would not be consistent with best practice if a market participant says there had been significant buying of Treasury securities by a large French bank or significant selling of agency MBS by a large REIT because it would likely reveal confidential information as "a large French bank" or "large REIT" may only be referring to one of a few potential counterparties in each case.
	3L. If TRACE provided public information that a specific mortgage TBA security traded at a specific price with a reported par amount of $25 million+, the actual size of the trade and the name of the counterparties would be considered confidential information and should be treated as such.
4. **Market participants should adopt written policies and procedures that identify and address limitations on the sharing and use of confidential information.** The policies may vary and should address risks, where they exist, associated with: ▪ **Sharing of information:** The extent to which confidential information, including pre- and post-trade information, can be shared internally or externally. The policies should also address the extent to which confidential information should be aggregated or anonymized prior to sharing. ▪ **Use of information:** The extent to which confidential information may be used, including, for example, in activities such as customer facilitation, investment decisions, trading or hedging.	**4A.** A mortgage investor has established a practice on disclosing covers on all of its specified pool trades. If the mortgage investor deviates from its practice on disclosing cover information based on the outcome of a transaction, such as disclosing only when the cover is tight, this would not be consistent with best practices.
5. **All market participants should be aware**	**5A.** A money manager usually discloses covers to its

of their counterparties' practices for handling confidential information; market participants should make available their practices for handling confidential information to their counterparties. Such practices may be a high-level summary of internal policies including, but not limited to, the handling of confidential information related to requests for quotes, requests for indicative prices, axes or other indications of trading interest, cover information, the placement of orders, inventory and details of completed transactions.	counterparties following a transaction. In a particular transaction the counterparty does not receive a cover, prompting the counterparty to ask the money manager to reaffirm its prior understanding about the money manager's practice for handling confidential information. It would be inconsistent with best practices if the money manager refused to clarify its practices for handling confidential information.
6. **Market participants should establish internal controls designed to ensure that confidential information is handled in a manner that complies with the established policies.** Such internal controls may include training of employees who have access to confidential information.	**6A.** At a money manager, a newly hired trader or an internal transfer into a trading role, does not receive adequate training about the firm's policies for the sharing and use of confidential information. This would be inconsistent with best practices as this trader will be unaware of how to handle confidential information in an appropriate manner.